United Nations E/2003/19

Economic and Social Council

Distr.: General
14 May 2003

Original: English

Substantive session
Geneva, 30 June-25 July 2003
Item 10 of the provisional agenda*
Regional cooperation

Summary of the economic survey of Latin America and the Caribbean 2002

Summary

Economic activity in Latin America and the Caribbean contracted by 0.6 per cent in 2002. As a result, the region's per capita gross domestic product (GDP) growth for the year was below the 1997 level, which means that a full half-decade has been lost to the region in terms of economic growth. The region-wide average was influenced by the South American economies, especially those of Argentina, Uruguay and Venezuela, but activity was slack in almost all countries. The unemployment rate reached an all-time high of 8.9 per cent, despite a considerable increase in informal employment. Social conditions deteriorated concomitantly and 7 million people across Latin America and the Caribbean fell below the poverty line.

The adverse external environment was a determining factor in the region's poor economic performance. Three factors were particularly influential, although their effects varied from country to country. The first was the deterioration in financing conditions, which had an especially strong impact on the Southern Common Market economies in terms of both the cost and volume of external resources. The second was the loss of momentum in the United States economy in 2001-2002, which affected Mexico, Central America and parts of the Caribbean in particular. The third was the worsening terms of trade for non-oil-exporting countries, which lost ground in this respect for the fifth year running.

* E/2003/100.

03-35904 (E) 120603

The response capacity of domestic economic policy was very limited. Most of the countries deployed tight monetary and fiscal policies in an effort to shield their currencies against exchange-rate pressures and attain a sustainable trend in terms of the accumulation of public debt. In most instances, real exchange rates were the only factor that helped boost the production sector's competitiveness. Few countries enjoyed enough economic manoeuvring room — carried over from previous years — to pursue countercyclical economic policies.

Inflation rose to 12 per cent, double the rate for 2001, owing almost entirely to currency devaluations, since wage trends were generally in line with changes in productivity.

Even though average GDP growth for 2002 was weak, it picked up pace as the year progressed, with a positive rate being posted for the final quarter. The continuation of this trend underlies projections of a 2 per cent growth rate for the region in 2003.

Contents

		Paragraphs	Page
I.	General outlook	1–16	3
II.	External sector	17–39	6
III.	Macroeconomic policy	40–53	10
IV.	Domestic economic performance	54–75	12

I. General outlook

1. Economic activity in the region declined by 0.6 per cent in 2002, resulting in a negative per capita growth rate (-2 per cent) for the second year in a row. The hardest-hit economies were Argentina, Uruguay and Venezuela, while per capita GDP was flat in the rest of the countries. This performance rounds off five years of sluggish growth (-0.3 per cent average annual per capita GDP growth since 1998) within an adverse international economic environment. Social conditions in the region have deteriorated in line with these trends.

2. The slump in GDP is largely attributable to the economic slowdown in 2001. The great majority of the countries in the region witnessed a break in this trend in the first half of 2002, however. Even the downward slide in Argentina's economy came to a halt in the second quarter of 2002 (over half of the contraction in GDP for 2002 is due to the downturn that preceded the discontinuation of the convertibility regime). These short-term swings in economic performance have been kept within a range of quite low rates, however, and thanks to the continuation of this mild recovery, the region's GDP is expected to expand by 2 per cent in 2003.

3. The region's performance has been influenced by the adverse international economic conditions generated in 1998 by the repercussions of the Asian crisis and the imbalances that built up during the 1990s. The external events that have had the strongest impact on the region have been the deterioration in international financial conditions, the slowdown in economic activity in the United States and the steady decline in the non-oil-exporting countries' terms of trade.

4. The most significant factor of all was the downturn in the international financial market, which had a particularly strong impact on the Southern Cone Common Market (MERCOSUR) economies. Net external resource transfers for Latin America as a whole amounted to -US$ 39 billion in 2002 (2.4 per cent of GDP at current prices), with half of that figure corresponding to Argentina. The economies more affected by this phenomenon (measured as a percentage of GDP) were Uruguay, Argentina and Venezuela.

5. The prevailing external financial conditions were also reflected in higher risk premiums on external public debt paper (i.e., widening sovereign spreads), which more than offset the decrease in international interest rates. In 2001, Argentina had moved beyond the 4,000 basis-point threshold, and its spread soared to nearly 7,000 basis points in 2002 — an order of magnitude associated with a perception of insolvency. Contrary to what the international financial community had assumed, the situation in Argentina had a direct impact on Uruguay and Paraguay, as well as indirectly affecting other economies in the region.

6. The uncertainty generated by the presidential elections in Brazil drove sovereign spreads up to over 2,400 basis points. This state of affairs reflected an overreaction by the financial market to a country which, after several years of adjustment, was running both a primary fiscal surplus and a surplus on its trade balance. The conclusion of an agreement with the International Monetary Fund (IMF) eased financial tensions somewhat and spreads began to narrow, although not to a sufficient degree.

7. Slackening economic activity in the United States in 2001-2002 was also a significant factor, especially in Mexico, the five members of the Central American

Common Market, the Dominican Republic, Haiti and Panama. Only three of these countries (Costa Rica, the Dominican Republic and El Salvador) had positive per capita GDP growth rates, but even in these cases the rates were below their historical averages.

Latin America and the Caribbean: main economic indicators

	2000	2001	2002[a]
Economic activity and prices	*Annual growth rates*		
Gross domestic product	3.8	0.3	-0.6
Per capita gross domestic product	2.2	-2.9	-2.0
Consumer prices	9.0	6.1	12.2
Terms of trade	6.0	-2.9	-0.3
	Percentages		
Open urban unemployment	8.4	8.4	8.9
Fiscal balance/GDP[b]	-2.5	-3.2	-3.4
External sector	*Billions of dollars*		
Exports (goods and services)	407.4	392.0	390.9
Imports (goods and services)	420.5	412.2	381.3
Merchandise trade balance	4.5	-1.2	23.4
Services trade balance	-17.6	-19.0	-13.8
Balance on factor income account	-53.2	-54.6	-51.1
Balance on current account	-46.0	-51.0	-15.1
Balance on capital and financial account	60.7	32.6	-12.5
Overall balance	14.7	-18.4	-27.6
Net resource transfers	-0.2	-4.8	-39.0

Source: ECLAC, on the basis of official figures.

[a] Preliminary estimates.

[b] Simple average.

8. The terms of trade for Latin American economies have deteriorated since 1998, except in the case of net exporters of petroleum and petroleum products (Venezuela, Ecuador, Mexico, Colombia and Argentina) and the Dominican Republic. The hardest-hit countries over the past five years, Brazil, Chile and Peru, have posted double-digit reductions. In 2002, Brazil, Bolivia and Honduras sustained the worst losses, with decreases of nearly 3 per cent or more.

9. Overall, the most conspicuous aspect of economic policy in 2002 was the authorities' loss of a degree of freedom in managing economic events as they unfolded. This loss of manoeuvring room was attributable both to the greater external constraints and to the imbalances that had built up during the years when the economic outlook was brighter.

10. In consequence, with very few exceptions, monetary policy in the region was contractive, mainly in response to pressure on exchange markets. In the economies

that were affected the most by these financial disturbances, the depreciation of their currencies generally overshot the mark, while the trend in sovereign spreads was reflected, in most cases, in rising domestic interest rates. Some countries (for example, Chile, Colombia, Mexico and Peru) were able to pursue expansionary monetary policies. These policies were not, however, always successful in galvanizing public-sector credit owing to the cautious stance adopted by banks and borrowers alike. Fiscal policy also had less manoeuvring room in most of the region's economies. This was partly because the available degrees of freedom had already been used to implement countercyclical policies in the three preceding years. Some of the countries carried on with their efforts to improve public finances by employing structural means to boost fiscal revenues. They include Brazil, Colombia, the Dominican Republic, Ecuador, Guatemala, Nicaragua and Panama. Accordingly, most of the region's economies implemented fiscal policies designed to address public debt sustainability, thereby generating an additional contractionary force.

11. The chief lesson to be learned in this respect is that the capacity to pursue countercyclical fiscal policies is built up during economic booms. If, on the other hand, procyclical policies are implemented during boom years, then, during economic busts, fiscal authorities will have no choice but to use policy measures that will inevitably amplify recessionary factors.

12. Uneven trends in real bilateral exchange rates within the region were another hallmark of the year 2002. With the exception of Ecuador, Guatemala and Trinidad and Tobago, all countries' currencies depreciated against the dollar and the euro in real terms. Trends in real bilateral exchange rates within the region, on the other hand, were quite mixed. Nevertheless, in 2002 it was seen that real exchange rates would eventually align themselves with the level of competitiveness exhibited by a country's production sector. Whenever exchange policy has diverged from that course — either because it has been used as a nominal anchor to stabilize the inflation rate or because financial stimuli have temporarily pointed in the other direction — the deterioration in the production sector's competitive position has eventually made a change in policy necessary.

13. The adverse signals sent out by the international economy and the national policy responses to them affected the economies of South America the most, and these economies were also the ones that had the greatest influence on the regional averages. Crises in three of the four Southern Common Market economies grew more serious. This was especially the case in Argentina and Uruguay, while Brazil posted a modest economic growth rate (1.5 per cent). Among the other countries of South America, Venezuela was conspicuous for a contraction in GDP of nearly 9 per cent. Peru and, to a lesser extent, Ecuador and the Dominican Republic were the only other countries to turn in a fairly strong growth performance in 2002. The other countries of the region were unable to halt the decline in their economies' forward momentum. The English-speaking Caribbean had a mixed performance, but on the whole managed to achieve a moderate rate of growth.

14. Gross fixed capital formation (measured as a percentage of GDP) fell for the fourth year running in 2002. Lower investment would appear to be a harbinger of a reduction in growth potential over the medium term and, in the more critical cases, short-term growth may have to be buttressed by the use of production resources that have been underutilized (unemployment, underemployment and idle production

capacity) during the recent spate of recessions. The lower level of investment in 2002 was not associated with a drop in national saving, but was instead the natural counterpart of the adjustment in the deficit on the balance-of-payments current account (or external saving). The adjustment in this variable amounted to the equivalent of 1 per cent of GDP at current prices in 2002, as compared to the 2.7 per cent average for the 1990s, and was primarily achieved through a reduction in imports. The combination of decreases in investment and external saving revealed the existence of the external constraints generated by an underutilization of domestic factors of production and a situation in which the balance of payments has come to exert a decisive influence on the level of economic activity. For the majority of the region, this was the first time that such a situation had arisen since the 1980s. These external constraints were particularly severe for the four economies of the Southern Common Market.

15. The unemployment rate climbed from 8.4 per cent of the workforce in 2001 to a regional record of 8.9 per cent. These figures attest to the cyclical nature of employment, but they also underscore the structural deterioration seen throughout the preceding decade, which has been reflected in unemployment levels even higher than those seen during the crisis of the 1980s. Real wages were, on average, 1.6 per cent lower than in 2001. The Economic Commission for Latin America and the Caribbean (ECLAC) estimates that during 2002 the number of poor people in the region swelled by over 7 million.

16. Inflation doubled, rising to 12 per cent. This was a direct consequence of the nominal devaluations that occurred, rather than the result of pressure for wage increases that would have outstripped productivity gains.

II. External sector

17. Net external resource transfers for the region as a whole amounted to -US$ 39 billion in 2002, or 2.4 per cent of GDP. The net inflow of resources had been reversed in 1999, but the region had not seen an outward flow of this size since the late 1980s. The main reason for this was the steep reduction in net capital inflows, coupled with a drastic adjustment in the trade account brought about chiefly through a contraction of imports. Sluggish world production and trading activity served as the backdrop for these developments.

18. The regional trade balance went from a US$ 20.2 billion deficit in 2001 to a US$ 9.6 billion surplus in 2002. This was the first positive balance to be recorded in over a decade. The hefty trade surpluses posted by Argentina, Brazil, Venezuela and, to a lesser extent, Chile more than made up for the other countries' shortfalls. A positive balance was also registered for current transfers. These transfers, which are mainly composed of family remittances and have come to represent an important source of external finance for some countries, maintained the upward trend of the preceding years, climbing to over US$ 26.3 billion.

19. The trade surplus and transfers were not enough to cover net payments of profits and interest, which amounted to US$ 51 billion. At US$ 15.1 billion (1 per cent of regional GDP), however, the resulting deficit on the regional balance-of-payments current account for 2002 was far smaller than the deficit of over US$ 51 billion registered in 2001.

20. The financial disturbances which troubled the region were reflected in the erosion of the capital and financial accounts on the balance of payments. Problems in obtaining external financing, dwindling inflows of foreign direct investment (FDI) and large-scale outflows of short-term capital resulted in a steep decline in net inflows of autonomous capital, especially in Argentina, Brazil, Uruguay and Venezuela. The region's deficits on the current and financial accounts were covered with compensatory financing and a small reduction in international reserves.

Capital inflows reached their lowest point since 1989

21. In 2002, as conditions in international financial markets deteriorated, capital flows to Latin America and the Caribbean slipped to the lowest levels seen since the late 1980s. Owing, in part, to the climate surrounding the run-up to the elections in Brazil, investors became increasingly risk-averse, especially in the period between June and September. As a result, the region's external borrowing conditions took a turn for the worse as widening sovereign spreads more than offset reductions in international interest rates. These financial disturbances abated in late 2002 and early 2003, however, and spreads began to narrow, particularly for Brazil.

22. Capital inflows amounted to US$ 12 billion in 2002, as compared to the US$ 58 billion received annually by the region, on average, between 1991 and 2001. The downturn in compensatory capital flows was widespread and the figures for some of their principal components were negative in net terms. This situation is likely to persist in a number of countries owing to the high levels of debt that they had built up during the 1990s and the continuing "flight to safety" that has curbed inflows of capital to "emerging" markets.

23. Among the components of autonomous capital flows, foreign direct investment totalled US$ 40.3 billion, which was far below the annual average of US$ 67 billion recorded between 1997 and 2001. This decline was due in part to short-term factors, which, depending on the country concerned, ranged from recession to greater political instability or the uncertainty generated by changes in the economic situation (all of which occurred in Argentina, for example) and in part to longer-term factors such as the completion of privatization processes in many of the countries.

24. Following a period (1992-1997) during which capital flows from international banks had returned to the region in abundance, net financial flows to the region began to taper off. The region's debt to international banks shrank by about 20 per cent between late 1997 and late 2002. Equity flows remained volatile and the first half of the year saw a net outflow of capital.

25. Another major source of financing in the 1990s was provided by international bond issues. In 2002, international bond placements totalled US$ 19.5 billion, or about half the figure recorded for 2001. The bulk of these operations consisted of sovereign bond issues, most of which were launched by Brazil, Chile, Colombia, El Salvador, Mexico and Peru, while the proceeds were used almost entirely for debt rollovers. There were few corporate bond issues during the year.

26. The terms and conditions of these bond issues continued to reflect the generally negative trend that has prevailed since the Asian crisis. Maturities remained at approximately seven years, while the average cost of new issues hovered around an annual rate of 11 per cent in the first quarter, before rising to 14 per cent in September and then dropping slightly thereafter. This average figure

masks a range of quite dissimilar cases, however. The increase was entirely attributable to the larger spreads paid by the countries of the region, since the yield on 10-year United States Treasury bonds held steady at about 4 per cent per year.

27. Given the countries' limited access to voluntary financing and the balance-of-payments crises affecting a number of them, compensatory financing, particularly from the International Monetary Fund (IMF), became extremely important. Battered by the Argentine crisis and with virtually no access to voluntary credit, Brazil and Uruguay were able to secure sizeable IMF loans. Other countries were unable to secure loans from this source, however, since they had not yet reached an agreement on conditionalities.

Foreign trade continued to feel the effect of the sluggish global economic environment

28. The world economy's general lack of momentum in 2002 led to a further decline in the terms of trade for most of the countries (particularly the non-oil-exporting countries), strengthening the downward trend observed since 1998, following the Asian crisis.

29. Lower commodity prices were the main cause of the downturn. The commodity price index for products other than oil exported by Latin America and the Caribbean dropped by 1.2 per cent in 2002 with respect to the average for 2001, resulting in a cumulative decline of nearly 6 per cent in two years. Raw materials (especially minerals) were the most seriously affected, along with some food products (in particular sugar and shrimp). Coffee was again the most dramatic casualty, however, as prices slid by another 10 per cent, prolonging the downward trend. Exceptions to this trend included grains, fishmeal, wool and gold.

30. The unfavourable external environment was also reflected in exports, which grew fairly haltingly (by less than 2 per cent) for the region as a whole and shrank in nearly half of the countries.

31. The United States market was far from being the engine of growth for neighbouring countries that it had been until 2000. The sales of Caribbean Community (CARICOM) member countries to that market (which is a vital one for them) actually decreased. Bahamas, Montserrat and Saint Kitts and Nevis were among the few exceptions in this respect.

32. The contraction of the intraregional market by an estimated 14 per cent, owing to the slack pace of economic activity in the region, also hurt export volumes. The sharpest decrease (37 per cent) was seen in the Southern Common Market countries, where the proportion of total exports represented by intraregional sales declined to 11 per cent, as against the 25 per cent share recorded in 1998. Trade within the Andean Community was down by 7 per cent, while sales within the Central American Common Market were flat.

33. In many countries, currency depreciations led to a contraction in imports rather than to an expansion of exports. This was due to the predominance of commodities — whose supply is inelastic in the short term — among the export products sold by most countries in the region. Brazil departed from this trend, however, with a sizeable increase in its export volumes being registered in the second semester thanks, among other factors, to the increased competitiveness generated by the devaluation of its currency.

As a result, exports weakened and imports were lower in most of the countries

34. All in all, merchandise export earnings declined in a majority of the countries, while an even larger number witnessed a decrease in imports.

35. The Central American countries had to contend with lower prices for their main agricultural exports, including coffee, sugar and bananas, as well as with the downswing in the United States market. Costa Rica and El Salvador, where manufactured goods produced under the maquila and free-zone systems represent a large percentage of total exports, were the only economies in which sales rallied from their previous downturns, and the recovery was a limited one in the case of Costa Rica. In the case of Mexico, whose main trading partner is the United States, exports dropped during the first quarter and, although they then picked up somewhat, export growth was almost flat for the year as a whole, thereby preventing the economy from regaining any of the ground it had lost in 2001. With few exceptions, these countries' imports followed a pattern similar to their exports. This trend can be attributed to the influence that exports have on economic activity in these countries and to the importance of their maquila sectors.

36. In the Caribbean Basin countries, tourism, another important source of foreign exchange earnings, showed only feeble signs of recovery from the shocks generated by the slowdown in the United States economy and the terrorist attacks of 11 September 2001. Figures for the early months of the year pointed to flat growth or further reductions both in tourist arrivals and in tourism earnings. The few positive signs included an increase in cruise ship arrivals for Belize, following agreements signed with a number of cruise lines, and more stopover arrivals in Grenada, Saint Kitts and Nevis, and Saint Vincent and the Grenadines in the first quarter and in Saint Lucia in the third.

37. The decrease in the import levels of Argentina (-56 per cent) and Brazil drove down the exports of all the Southern Common Market member countries except Brazil. Uruguay, which was hit the hardest, posted a double-digit drop. By contrast, among the Andean countries, the export volumes of the extractive industries of Peru increased, while Ecuador and Venezuela benefited from higher crude oil prices. The trend in the trade balances of these last two countries continued in opposite directions, with increases being recorded both in Venezuela's surplus and in Ecuador's hefty deficit. These results reflected a 30 per cent drop in Venezuelan imports, which was caused by the economic recession in that country and the devaluation of the bolivar, and an upswing of over 20 per cent in Ecuador's imports due to the ongoing construction of a pipeline to transport heavy crude oil and the continuing appreciation of its currency in real terms.

The external debt showed no increase in 2002

38. Latin America's gross external debt exhibited a nominal decline of 0.4 per cent in 2002, which brought it to US$ 725 billion. In a year during which the countries of the region had difficulty gaining access to external financing, most of them registered very small increases or nominal decreases in their external liabilities. Very few countries engaged in additional net borrowing. Among those with the biggest increases were Ecuador (10 per cent), owing to the expansion of private debt, and Uruguay (19 per cent), which undertook new commitments with multilateral institutions.

39. More than half of the Latin American and Caribbean countries — generally those whose economies are more open than the regional average — kept their two traditional debt burden indicators within a moderate range. In contrast, Bolivia, Brazil and Peru, which were among the most heavily indebted nations, had an external debt/GDP ratio of close to 50 per cent and a debt/exports ratio of around 300 per cent. Even so, it is encouraging to note that this indicator has been steadily improving in Brazil and Peru since 1999. In Ecuador and Uruguay, however, both indicators have deteriorated.

III. Macroeconomic policy

40. The year 2002 saw a further loss of degrees of freedom in fiscal and monetary policy management in most of the economies of the region. The manoeuvring room available to fiscal policy makers had been declining over the preceding five years as the fiscal deficit grew, reaching 3.2 per cent of regional GDP in 2001. Given the tighter external financial environment, Governments were obliged to adopt more restrictive fiscal positions in order to build up their policies' credibility and to raise domestic interest rates in order to counter the pressure exerted on their currencies.

41. These conditions brought the issue of the public debt and its sustainability to the forefront once again. The volume of debt had expanded owing to the growth of the fiscal deficit since the outbreak of the Asian crisis and this, in conjunction with the economic slowdown, drove up the public debt/GDP coefficient. The problem was exacerbated by the developments in monetary and exchange-rate policy triggered by interest-rate hikes (which made it more costly to service domestic debt) and currency depreciations (which had the effect of increasing foreign-currency debts when expressed in the local currency). The main channel of transmission for financial contagion, however, was investor behaviour, which gave rise to a self-fulfilling prophecy. Indeed, investors ignored such circumstances as, for example, the fact that two countries with a high public debt/GDP ratio (Ecuador and Brazil) posted large primary surpluses, which clearly signalled the major effort being made by these nations to meet their obligations.

Fiscal policy tended to take a passive approach

42. In most cases, fiscal expenditure was not used to buoy economic activity in the face of weak revenues. In some cases, this was because spending had already been used for that purpose in previous years and it would have been risky to continue to do so; in others, it was because fiscal policy management capacity had not been reinforced during earlier years when the economy was growing more rapidly. In addition, fiscal management capacity was further eroded by the increase in the public debt burden.

43. Revenues were down in most of the South American countries and in all the economies that were in recession. The decrease was especially steep in Argentina and Uruguay, where it amounted to around 20 per cent in real terms. Revenues were higher, however, in approximately half the countries of the region, especially the Central American and Caribbean countries. In a number of oil-exporting countries, the increase was attributable to higher crude oil prices, while in other countries (including the Dominican Republic, Guatemala and Nicaragua) it was associated with tax reforms. Argentina, Colombia, Uruguay and Venezuela also took steps to improve tax collection and counteract the deterioration of the fiscal situation.

44. Fiscal expenditure contracted in many countries, either because of the pressures generated by the difficult economic situation (as in Argentina, Paraguay, Uruguay and Venezuela) or as part of the implementation of medium-term stabilization programmes within a context of moderate economic growth (as in the Central American countries and Panama). In many instances public investment was the adjustment variable, as it occurred in Honduras, Nicaragua, Panama, Peru, Paraguay, and Trinidad and Tobago. In other countries — Barbados, Brazil, Chile, Costa Rica, the Dominican Republic, Ecuador and Jamaica — expenditure levels were either maintained or raised.

45. As the net effect of these trends in revenues and expenditure, the public sector balance — a deficit equivalent to 3.4 per cent of regional GDP — was largely unchanged. This figure conceals sharp differences across countries, however. The contrasts are illustrated by the results for the region's three largest economies: Argentina's deficit shrank from 3.1 per cent of GDP in 2001 to 1.4 per cent in 2002; Mexico's increased slightly, from 0.7 to 1.2 per cent; and Brazil's grew from 1.4 to 4.7 per cent. Fiscal deficits, which were an across-the-board phenomenon, narrowed in half of the countries and widened in the other half.

46. The main source of financing to cover the South American countries' deficits was the domestic financial market. Some countries, such as Argentina and Brazil, had trouble obtaining funds from this source, however. The impending elections made it difficult to refinance domestic debt in Brazil, which consequently undertook sovereign bond issues when the opportunity arose. This approach was also used by Chile, Colombia, Jamaica, Mexico, Peru, Uruguay and several Central American and Caribbean countries, while others chose to borrow from international financial institutions.

Exchange-rate pressures and their influence on monetary policy

47. As a result of the financial disturbances, many countries experienced significant currency depreciation, which forced the authorities to implement contractionary monetary policies to defend their currencies and stave off inflation. Only Chile, Colombia, Mexico and Peru were in a position to adopt more independent and more countercyclical monetary policies. Their effectiveness was impaired, however, by the fact that financing terms for the private sector failed to improve in many cases.

48. The economic crises besetting Argentina, Uruguay and Venezuela forced those countries to switch over to a currency float, with the result that their currencies depreciated sharply in both nominal and real terms in relation to the dollar, the euro and the currencies of other countries outside the region. The abolition of Argentina's convertibility regime triggered a steep real depreciation of the Argentine peso in the first half of the year, both against the dollar and against the currencies of its main trading partners. Subsequently, however, the exchange rate regained some of the ground it had lost. As a result of financial turmoil in Brazil, the Brazilian real depreciated against the dollar in real terms, losing one third of its value by the end of the year. The Venezuelan bolivar's depreciation amounted to nearly one fourth, on average, in the final quarter.

49. The magnitude of these depreciations largely determined the movements observed in the effective exchange rates (with respect to all trading partners) of most of the Latin American countries, whose currencies depreciated to varying degrees

against the dollar and the euro, but appreciated against the currencies of their trading partners in the region. This effect was especially pronounced in the South American countries (particularly Bolivia, Brazil, Chile and Paraguay), which have strong trade ties with the economies hardest hit by depreciation.

50. Guatemala and Trinidad and Tobago were the only non-dollarized economies to experience a real appreciation of their currencies against the dollar, thanks to strong capital inflows. Two of the region's three dollarized economies — El Salvador and Panama — remained on a low inflation path, which accounted for the stability of both their effective exchange rates and their bilateral rates of exchange against the dollar. In Ecuador, however, domestic inflation resulted in a loss of exchange-rate competitiveness of about 7 per cent against the dollar and 10 per cent overall against the currencies of its trading partners.

51. In most of the countries, monetary policy was shaped by changes in exchange-rate parities. This reduced the countries' capacity to use monetary policy as a countercyclical instrument in a context of sluggish productive activity. This situation was especially critical in those countries — like Venezuela and the members of MERCOSUR — which had come under strong exchange-rate pressure and had had to use significant hikes in deposit interest rates to shore up their currencies and to try to avert excessive depreciations that could trigger inflation and jeopardize their financial systems. Brazil was unable to maintain the policy of progressive interest-rate reductions which it had maintained until mid-2002 in an effort to foster economic recovery. Argentina applied a combination of strong monetary expansion and high interest rates, especially in the first half of 2002. Interest rates subsided in the second half of the year, when the peso began to appreciate, but credit stayed flat as a result of the banking crisis.

52. Countries where domestic interest rates dropped included those with dollarized economies (Ecuador, El Salvador and Panama), which benefited from the fall in international interest rates, and a small group of countries that had some leeway to implement countercyclical monetary policies. For example, Chile, Colombia and Peru kept inflation under control, at least for part of the year, while Mexico suffered only minor financial contagion from Argentina and Brazil.

53. The net supply of credit remained low in a significant number of countries owing to the greater caution exercised by local banks. Interest rate spreads stayed high and even increased in some countries, such as Argentina, Aruba, the Bahamas, Barbados, Bolivia, Brazil, Colombia, Costa Rica, the Dominican Republic, Guyana, Haiti, Nicaragua, Panama, Paraguay and Uruguay. Declines in deposit rates were not matched by a proportional fall in lending rates, which suggests that the commercial banking system was following a conservative policy in view of the uncertainty arising from the external economic environment and, in some cases, also the domestic one. Thus, the cost of credit was still very high, restricting the availability of financing for production, especially in the case of small and medium-sized enterprises.

IV. Domestic economic performance

54. Economic activity contracted by 0.6 per cent. This rounded off five years of economic stagnation in the region, whose per capita GDP fell below the figure recorded in 1997. The drop in economic activity was compounded by a decline in

employment, which pushed the unemployment rate up to a record high. At the same time, slack domestic demand kept inflation in check (although the rate was higher than in 2001), thus helping to moderate the loss of purchasing power.

Downturns in investment and regional GDP

55. While the decrease in the region's per capita GDP for the second year running was due in part to the sharp decline in economic activity in Argentina, Uruguay and Venezuela, virtually all countries posted sluggish growth rates (of under 2 per cent in the vast majority of cases).

56. This situation was primarily the result of adverse international economic conditions, which reduced the volume of trade, the prices of non-oil exports and capital movements. These factors combined with a number of domestic factors that restrained growth in most countries, including tight monetary policies, flat domestic credit, fiscal problems, high levels of public and private debt, speculative pressures that affected interest rates, high rates of unemployment and underemployment and, in several countries, social and political disturbances. Some countries were also troubled by adverse weather conditions. On the other hand, there were some positive domestic situations related to the exploitation of natural resources, a slight recovery in domestic demand and success in solving specific problems, such as electricity rationing in Brazil.

57. The influence of these factors varied from one country to another. One group of countries was hit hardest by economic trends in the United States, where demand for imports lost momentum in the biennium 2001-2002. The Dominican Republic, Haiti, Mexico, Panama and the Central American Common Market countries were in this category. The Mexican economy grew by 0.9 per cent, which translated into a further decline in per capita GDP. The listlessness of the Mexican market also had adverse effects on the Central American countries, where the weakness of United States demand was compounded by the severe crisis that continued to plague the coffee industry, which had serious repercussions for agricultural production and employment. Together, these factors led to a small downturn in per capita output, except in El Salvador and Costa Rica, where per capita GDP rose by about half a percentage point. In general, growth in the Caribbean countries was weak, owing in many cases to the tourism industry's failure to recover fully from the downswing it had suffered in 2001 and, in some cases, to climatic phenomena, such as floods in Jamaica and poor weather conditions in Barbados and Cuba.

58. Other countries had high levels of domestic and external debt, which made them particularly vulnerable to the toughening of international borrowing conditions and to speculative attacks. This category included the four countries members of the Southern Common Market. In Argentina, the steep decline in output that began in mid-2001 continued into the first quarter of 2002, but stopped and began to reverse itself in the second. However, for the year as a whole Argentina's GDP contracted by 11 per cent, largely reflecting the statistical effect of the collapse in output in the second half of 2001. The Argentine crisis spread to Uruguay and Paraguay, in particular, by a number of means. Those countries' GDP shrank by 10.5 per cent and 3 per cent, respectively. Brazil was vulnerable to financial disturbances, which led to a rise in interest rates, though output nevertheless grew by 1.5 per cent. This group of countries also includes Bolivia, which was the Andean country worst affected by the crisis in the MERCOSUR bloc.

59. Chile was particularly affected by an unrelenting downward trend in its terms of trade. This deterioration, which had persisted ever since the Asian crisis, resulted in a cumulative decline of 20 per cent over five years. That factor was largely to blame for the steady slowdown in the country's economic activity.

60. Lastly, in most of the Andean countries, domestic factors pushed external issues into a secondary role as determinants of economic performance. Ecuador continued to recover from the severe crisis of 1999, although per capita output stayed below its 1998 level. The Peruvian economy, which had been experiencing an upswing, grew by more than 5 per cent. This performance was attributable to the commencement of operations at the Antamina mine, among other factors. In contrast, Venezuela, in the throes of a severe political crisis, saw its GDP slip by nearly 9 per cent, despite the high price of its main export product, petroleum. Colombia was also unable to take full advantage of higher petroleum prices and its economy grew by only 1.6 per cent, even though the Government deployed a generally expansionary monetary policy.

61. Gross fixed investment contracted again by slightly over 6 per cent, which placed the regional investment rate at barely 18 percentage points of GDP (at 1995 prices), even lower than the rates recorded in the late 1980s and early 1990s. The steepest downturns were experienced in the South American countries, where, as tends to occur in a recession, fixed investment was the component of global demand that contracted the most. In this particular recession, limited export prospects combined with the higher cost of imported capital goods (inflated by the effect of devaluation), while scarce or expensive financing slowed down construction activity. Investment was also discouraged by political instability or conflict in some countries. Ecuador was the only country in the subregion to record significant growth in this respect, thanks to the construction of a new oil pipeline. In Central America and Mexico, investment ratios remained relatively unchanged.

62. The downturn in investment took place despite an increase in national saving, which was matched by a contraction in public and private consumption. The increase in national saving was offset by a decline in external saving, reflected in a narrowing of the balance-of-payments current-account deficit from 2.7 per cent of GDP in 2001 to about 1 per cent in 2002.

63. Since most countries began to experience an economic upturn in the second quarter of 2002, the region as a whole can be expected to grow in 2003, though by only about 2 per cent, this should translate into a slightly positive variation in per capita growth. This projection is based on an improvement in the situation of external trade and financing conditions. However, it remains subject to a great deal of uncertainty with respect to the economic and political factors on which it depends. Economic factors include, primarily, the price of oil and the growth prospects of the main industrialized countries, which are of decisive importance for international trade. Political factors include the effects of the conflict in the Middle East and the political problems facing a number of countries in the region.

64. With these caveats, it is expected that, by the end of 2003, few countries will find that their situation has worsened since 2002. This projection varies from one country to another, however. The biggest improvement should take place in Argentina, which is expected to post a growth rate of 4 per cent. However, it will be some time before this recovery is felt in Argentina's neighbours, Paraguay and Uruguay. Growth rates should tend to converge in the rest of South America, since it

is probable that many countries will experience faster growth — albeit to only a slight degree in some cases, such as those of Brazil and Colombia — and that the economies of Peru and Ecuador will lose momentum. Only Venezuela appears likely to suffer an even more drastic fall in GDP, which could be as steep as 10 per cent. Notwithstanding the sluggishness of economic recovery in the United States, the economies of Mexico and the Central American countries will probably grow by 2 to 2.5 per cent, and the Caribbean countries could experience a modest upturn.

Higher but still moderate inflation in the region

65. Inflation for the region as a whole in 2002, measured by the consumer price index, moved up after eight years of steady decline, reaching 12.2 per cent; this is twice the rate recorded in 2001. Wholesale prices rose even more sharply (as was to be expected in a context of widespread devaluation), posting an annual rate of 29 per cent.

66. The upsurge in inflation essentially reflected those devaluations, which in some countries were quite severe. Devaluations are to blame for the inflation rates of 41, 31 and 26 per cent posted in Argentina, Venezuela and Uruguay, respectively. In other countries, inflation did not reach these orders of magnitude, but significant currency devaluations were nonetheless observed, especially in the second half of 2002, and were reflected in higher inflation rates towards the end of the year. Despite these developments, the increase in region-wide inflation did not seem to signal a trend; rather, it represented the region's response to an exchange-rate shock that was gradually absorbed without giving rise to sustained inflationary processes. Accordingly, in almost every case price hikes were much more modest than the devaluations that caused them — which impacted more significantly on real exchange rates — evincing the moderating effect that low growth or recession has on inflation.

67. Among the countries with the sharpest price hikes, Argentina experienced a powerful resurgence in inflation, after a decade of stability, when the drastic change in its exchange-rate regime caused the currency to lose nearly three fourths of its value. As a result of the deep recession and high unemployment, nominal wages were not significantly adjusted to offset the sharp increase in prices. This, together with the exchange rate's stability in the second half of the year, helped to slow inflation after its initial sharp upsurge.

68. In Venezuela, after having declined steadily for five years, inflation shot up as a result of the abandonment of the exchange-band system, which led to a sharp devaluation in the first part of the year. In Uruguay, the sudden rise in inflation was due to the steep devaluation of the currency, especially after the currency band system was discarded and replaced with a floating rate. The country's severe recession, combined with the problems caused by the financial crisis, the credit squeeze and the freezing of deposits in some institutions, softened the impact of the devaluation.

69. Brazil's 2002 inflation rate was 12.5 per cent, compared to 7.7 per cent the year before. The upsurge occurred near the end of the year as a result of the devaluation recorded between May and October. It was nonetheless kept from speeding up even further by persistently sluggish economic growth and a tight monetary policy. In Paraguay, consumer prices rose by almost 15 per cent in 2002 as a result of devaluation, which intensified beginning in the third quarter. In Haiti and

the Dominican Republic, inflation sped up as their currency devaluations sharpened in the final quarter.

70. In contrast to these cases, inflation in the other countries of the region either decreased or rose very slightly. Noteworthy in this regard were the sharp drop in inflation in Ecuador and the low rates that continued to be posted in Bolivia, Chile, Nicaragua and Peru, even though these four countries' exchange rates came under some pressure.

Deterioration in the labour market

71. The labour market turned in a weak performance in the context of a shrinking regional economy. The main labour trends were a steep decline in the rate of employment, a sharp rise in unemployment, the expansion of informal employment and sluggish job creation in small and medium-sized firms. As a result, many Latin Americans saw their living conditions take a turn for the worse in 2002. At the same time, real wages reflected patterns in rates of inflation and did not greatly diverge from labour productivity trends.

72. After dropping sharply in 2001, the rate of employment declined again in 2002, from 53.1 to 52.8 per cent, owing to the first negative rate of economic growth recorded in the region since 1983. Given that the rate of labour force participation rose slightly, regional unemployment climbed from 8.4 to 8.9 per cent, the highest figure recorded since comparable measurements became available. This deterioration in employment and unemployment rates was seen in nearly all the countries of the region, although it was worst by far in Argentina, Uruguay and Venezuela owing to those countries' severe economic crises.

73. The heavy downturn in the employment rate attested to the close correlation between economic growth and job creation, which has been a feature of labour market trends in recent years. Prior developments had suggested that employment would perform even more poorly in 2002 than it actually did. In many countries, corporate demand for labour, reflected in the generation of wage employment, was even weaker than the employment rate indicates. This slack demand was partly offset by the expansion of informal employment, mainly self-employment, as households responded to the pressing need to generate income.

74. Because the adjustment of nominal wages on the basis of past inflation was still a common practice, real wages in the formal sector were determined to a great extent by year-on-year inflation. This produced substantial declines in countries that experienced surges in inflation and small rises in countries where inflation subsided. Accordingly, variations in real wages in the formal sector ranged from -14 per cent in Argentina to over 4 per cent in Colombia, Costa Rica, Nicaragua and Peru. Depending on the method of calculation used, the region-wide variation in real wages, based on information from 12 countries, was either a 1.8 per cent increase (median) or a 1.6 per cent decline (weighted average).

75. In 2002 an inverse relationship was clearly visible between year-on-year inflation and economic growth. In keeping with these two trends, real wages grew faster in countries with higher rates of economic growth. Given that in many countries the bulk of the increase in employment was due to the expansion of activity in low-productivity sectors (for reasons of household subsistence), a calculation of changes in average labour productivity based on the variation in the

number of wage earners alone gives a positive correlation between labour productivity and real wages. In fact, real wages rose in countries that recorded an increase in the apparent productivity of wage earners and declined in the other countries. Thus, although real wages were strongly affected by the rate of inflation, they did not diverge much from productivity trends.

Annex

Latin America and the Caribbean: total gross domestic product

(Percentages, at 1995 prices)

	Annual growth rates											
	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002[a]*
Latin America and the Caribbean	**3.3**	**2.8**	**3.3**	**5.2**	**1.1**	**3.7**	**5.1**	**2.2**	**0.5**	**3.8**	**0.3**	**-0.6**
Latin America and the Caribbean (except Brazil)	4.7	4.7	2.6	4.5	-0.7	4.5	6.4	3.5	0.2	3.6	-0.3	-1.8
Subtotal (20 countries)	**3.3**	**2.8**	**3.4**	**5.2**	**1.1**	**3.8**	**5.2**	**2.2**	**0.5**	**3.8**	**0.3**	**-0.6**
Subtotal (20 countries; Brazil not included)	**4.8**	**4.7**	**2.7**	**4.6**	**-0.7**	**4.6**	**6.5**	**3.5**	**0.2**	**3.6**	**-0.4**	**-1.9**
Argentina	10.6	9.6	5.9	5.8	-2.9	5.5	8.0	3.8	-3.4	-0.8	-4.4	-11.0
Bolivia	5.4	1.7	4.3	4.8	4.7	4.5	4.9	5.0	0.3	2.3	1.3	2.0
Brazil	1.0	-0.3	4.5	6.2	4.2	2.5	3.1	0.1	1.0	4.0	1.5	1.5
Chile	7.3	10.8	6.9	5.0	9.0	6.9	6.8	3.3	-0.7	4.4	2.8	2.0
Colombia	1.8	3.6	4.4	5.9	4.9	1.9	3.3	0.8	-3.8	2.2	1.4	1.6
Costa Rica	1.6	8.8	7.1	4.6	3.9	0.8	5.4	8.3	8.0	2.2	1.0	2.8
Cuba	-12.1	-13.8	-16.0	2.0	3.4	8.7	3.3	1.3	6.8	5.3	2.5	1.4
Dominican Republic	0.9	8.0	3.0	4.7	4.3	7.2	8.2	7.4	7.8	7.3	2.7	4.0
Ecuador	5.0	3.0	2.2	4.4	3.0	2.3	3.9	1.0	-7.9	2.3	6.0	3.4
El Salvador	2.8	7.3	6.4	6.0	6.2	1.8	4.2	3.8	3.4	2.1	1.9	2.3
Guatemala[a]	3.7	4.9	4.0	4.1	5.0	3.0	4.4	5.1	3.9	3.4	2.4	1.9
Haiti	0.2	-5.5	-8.0	-17.6	9.5	5.6	3.2	2.9	2.9	1.9	-0.7	-1.5
Honduras	2.7	5.8	7.1	-1.9	3.7	3.7	4.9	3.3	-1.5	4.8	2.7	2.0
Mexico	4.2	3.7	1.8	4.5	-6.2	5.4	6.8	5.0	3.7	6.8	-0.4	0.9
Nicaragua	-0.4	0.8	-0.4	4.0	4.4	5.1	5.4	4.1	7.4	6.4	3.0	1.0
Panama	9.0	8.2	5.3	3.1	1.9	2.7	4.7	4.6	3.5	2.6	0.4	0.4
Paraguay	2.5	1.7	4.0	3.0	4.5	1.1	2.4	-0.6	-0.1	-0.6	2.4	-3.0
Peru	2.7	-0.4	4.8	12.7	8.6	2.5	6.8	-0.5	0.9	3.0	0.2	5.2
Uruguay	3.7	8.3	3.5	7.0	-2.3	5.0	5.4	4.4	-3.4	-1.9	-3.4	-10.5
Venezuela	10.5	7.0	-0.4	-3.7	5.9	-0.4	7.4	0.7	-5.8	3.8	2.9	-8.8
Subtotal, Caribbean	**1.6**	**0.6**	**0.9**	**3.1**	**2.7**	**2.6**	**2.0**	**3.6**	**2.8**	**3.5**	**1.8**	**1.9**
Antigua and Barbuda	2.7	0.9	5.0	6.2	-4.8	6.0	5.5	5.0	4.9	2.6	4.3	0.0
Barbados	-3.8	-6.8	1.1	4.4	1.9	2.5	2.6	4.0	3.0	3.1	-2.2	-0.4
Belize	3.2	9.0	4.3	1.5	3.7	1.3	4.4	2.0	6.0	10.5	4.7	3.7
Dominica	2.1	2.3	1.9	1.9	1.2	2.9	2.2	3.1	1.3	0.7	-5.2	-6.0
Grenada	3.7	1.0	-1.1	3.4	3.1	3.0	4.3	7.6	7.5	6.5	-3.3	3.0
Guyana	8.9	9.1	11.4	9.4	3.8	7.4	6.8	-2.2	5.0	-2.3	2.3	2.0

	Annual growth rates											
	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002[a]*
Jamaica	0.5	2.7	2.2	1.6	2.2	-0.1	-1.8	-0.8	0.6	1.0	1.8	2.0
Saint Kitts and Nevis	2.5	3.2	5.2	5.5	3.2	5.8	7.2	1.1	3.5	5.0	2.0	-2.5
Saint Vincent and the Grenadines	1.5	6.9	2.0	-2.3	7.8	1.2	3.5	5.8	3.6	1.8	0.3	4.0
Saint Lucia	-0.4	7.5	-1.3	4.6	2.1	0.8	-0.3	3.0	2.8	0.3	-5.0	1.0
Suriname	3.5	-2.0	-4.1	-0.1	0.0	5.3	3.3	2.9	-3.5	-1.2	...	...
Trinidad and Tobago	3.5	-1.0	-1.2	4.2	4.2	4.4	4.0	7.8	4.4	6.1	3.3	2.7

Source: ECLAC, on the basis of official figures converted into dollars at constant 1995 prices.

Note: Where relevant, totals and subtotals do not include those countries for which information has not been included.

[a] Preliminary estimates.